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Political Business as Usual – Comparing Public-Private Partnerships in East and Southeast Asia¹

Johannes Dragsbaek Schmidt²

Most commentators have denounced the Asian financial crisis as the end of authoritarian state-directed capitalism. The crisis emerged with the devaluation of the Thai baht in July 1997 and quickly escalated to encompass most of the economies in East and Southeast Asia. Those events lead to a proliferation of explanations about the origins of the financial crisis, of which the four most common are the neoliberal view, an international conspiracy, financial panic and changes in political and social power at both the domestic and international levels.³ The most important explanation in terms of its direct policy implications is the neoliberal view, associated with the “Washington Consensus”,⁴ which argues that corruption and nepotism were the central factors that contributed to the crisis.

Let it be clear from the outset that this essay does not subscribe to the explanation that one of the major factors which triggered the crisis was a unique East Asian model of statism creating distortions and inefficiencies and involving a specific mode of cronyism with the direct consequence of misallocation of resources. Although this type of approach is the most common explanation for what caused a world wide scale crisis, it is also being used by the neoliberal ‘Washington consensus’ to reassert US strategic power and supremacy in the region through the increasing internationalisation of capital. Accordingly one scholar notes that the world economy is characterised by intense interstate conflict over the form and direction of regional and global patterns of capitalist development. Central to US strategy is the imposition of a specific neoliberal model of restructuring. In the context of recent crises, state-directed and controlled forms of political economy

¹ This is a slightly revised version of a paper presented at an international workshop “Political Business in East Asia” held at DIR, Aalborg University 4-5 June 1999. The workshop was co-organised by Research Center on Development and International Relations, Aalborg University, Department of East Asian Studies, Leeds University and Nordic Institute for Asian Studies, Copenhagen. The paper has benefited from comments by Terence Gomez.

² Associate Professor and Co-ordinator of DIR, Aalborg University.

³ For a brief and concise discussion on each of these four explanations, see Mark Beeson and Andrew Rosser (1999), ‘The East Asian Crisis: A Brief Overview of the Facts, the Issues and the Future’, Working Paper No. 86, Asia Research Centre, Murdoch University.

⁴ The International Monetary Fund (IMF), the World Bank, the US Treasury Department and the White House in Washington who formulate, plan and implement the hegemony of neo-liberalism.

have been, and are being, pressured to liberalize.”⁵ These neo-liberal arguments rely on a critique of the East Asian model for giving unfair advantage to local (as opposed to foreign) capital through state subsidies and political patronage. The solution is a free market system (which is ostensibly more efficient and transparent) based on investor interests and the maximisation of shareholder values.⁶

Although the position of this contribution contradicts the solution that the imposition of a free market system is the panacea to the financial crisis as well as a deterrent to its re-occurrence, it is also true that the large current account deficits and the loss of competitiveness with its resulting decrease in exports and attacks on currencies is an inadequate explanation for the crisis. This paper argues that the pressures arising from globalisation, which affected checks and balances provided by state regulation over the economy, or what Peter Evans has termed the embedded autonomy of the state, was a major contributory factor to the crisis.⁷

In this regard then, the financial crisis is more related to what Peter Drucker has termed as a social crisis. However, there is no doubt that the crisis is also a crisis of neoliberal globalisation, and the reinvention of nationalist economies, primarily through forms of protectionism and control of foreign capital. The resistance against neoliberal globalisation and foreign control of the local economies will once again become much stronger – in compliance with what Polanyi termed the double movement – potentially strengthening local and democratic control over the economies.⁸

⁵ Stephen Gill (1999), ‘The Geopolitics of the Asian Crisis’, *Monthly Review* 50 (10), March, p. 1.

⁶ The causes of the East Asian crisis cannot be explained at the ideological level alone. Other explanations for the cause of the crisis have been offered, four of which are worth mentioning: i) global overproduction and the fact that all economies gave preference to an export-oriented development model; ii) forced deregulation of financial and monetary control in East Asia by the IMF, World Bank and OECD in collaboration with international capital; iii) the revaluation of the Yen and later on the devaluation of the Chinese Renminbi which caused tremendous competitive pressure on the export-oriented economies adding to chronic overproduction; and iv) the growing influence and pressures from national business sectors on policymakers to prematurely deregulate the financial sectors. The result was overborrowing by the private market actors and a typical private sector debt crisis. Since significant segments of the private sector had become dependent on foreign finance, well illustrated by the unserviceable private sector debt problem, this also indicates that weak state regulation had allowed the private sector unrestricted access to international finance. Johannes Dragsbaek Schmidt (2000), ‘Neoliberal Globalisation, Social Welfare and Trade Unions in Southeast Asia’, in Barry Gills (ed.), *Globalization and the Politics of Resistance*, London: Macmillan, p. 236.

⁷ According to Evans, the efficacy of the ‘embedded autonomy’ of the developmental state “depends on a meritocratic bureaucracy with a dense set of institutionalized links to private elites.” Peter Evans (1989), ‘Preadatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State’, *Sociological Forum* 4 (4), p. 561.

⁸ In nicely capsulated title, a Japanese official, Eisuke Sakakibara, from the Ministry of Finance

The idea then that the concept ‘political business’ can offer insights into what caused the crisis has strategic as well as ideological consequences which must be taken into consideration. This, however, also questions whether the term political business is a unique East Asian variant of capitalism. There are historical and contemporary examples of cosy business-politics relationships in other countries, including the United States, Latin America, the former USSR and Eastern Europe, not to mention the European Union countries. Such alliances might also explain why Taiwan and China escaped the financial crisis in 1997 in spite of the fact that political business is just as prevalent in these two countries as in other parts of East Asia. To contend then that the crisis occurred because *dirigisme* and crony capitalism was extensive is both simplistic and unidimensional.

This paper argues that political business is a strategy pursued by most late-comers and a universally applied type of statism deliberately applied to catch-up in the global economy. What makes the strategy extremely vulnerable in East Asia is the fact that most countries, except the first-comer Japan, and also South Korea and Taiwan, have relied heavily on foreign capital as a primary engine in capital accumulation thus running the risk of retarded uneven development and over-reliance on external factors and actors i.e. a classical example of dependency. In the ideal type East Asian model as it developed first in Japan, and later on in South Korea, Taiwan and Singapore, and to a much lesser degree in Malaysia, Thailand, Indonesia and the Philippines, the nature of co-operative, long-term, reciprocal relations between companies, financial institutions and state agencies had evolved significantly before the advent of the crisis. As a matter of fact, the question regarding timing is of outmost importance in this regard as political business alliances are never static.

The paper is divided into three parts. Apart from the introduction the next part is devoted to a discussion on the differences between first-, second- and third-tier NIC economic development strategies in East Asia, and a distinction is made between kleptocratic, predatory and developmental states. The third section deals with the heavy dependence of the states in the latter category NIC countries in Southeast Asia on foreign capital to generate rapid economic growth in the 1960s and 1970s. From the mid- to late 1980s, after massive internal and external pressures to deregulate, liberalise and privatise the financial markets, the impact of the collusion between well-connected or influential private market actors and (usually) short-term financial capital is assessed. The argument is made that extensive liberalisation and deregulation of the economy had grave consequences for the nature of political business alliance which led to the ascendancy of capital over the

showed East Asian frustration with the imposition of US hegemony in the region with a speech entitled ‘The End of Market Fundamentalism’. See Gill, op cit., p. 8.

state. The final section rounds up the often heated debate concerning which role is appropriate of the state in economic development in the future, especially taking into consideration that globalisation of both markets and politics seem irreversible in the near future.

New Wine in Old Bottles: Nurtured Political Business Alliances in East Asia

When Woodrow Wilson was President of the United States, he wrote: “Suppose you go to Washington and try to get at your government. You will always find that while you are politely listened to, the men really consulted are the men who have the biggest stake - the big bankers, the big manufacturers, the big masters of commerce, the heads of railroad corporations and of steamship corporations... The masters of Government of the United States are the combined capitalists and manufacturers of the United States.”⁹ While it is true that those with economic power dominate US politics, it is also a truism that irrespective of type of regime, money plays a dominant role in politics. This then raises the question whether political business is a phenomenon specific to Asia or if it is an inescapable part of successful catching-up capitalism?

The answer to this question is self-fulfilling: State intervention in the economy has been a major characteristic of all late developing economies. Unlike the private entrepreneur who is conditioned to respond to market events to maximise profits, political business actors (or state entrepreneurs) simultaneously respond to three sets of incentives: market profits, the rewards structured within the party and state hierarchy, and in some cases social and communal demands from their constituencies.¹⁰ One might be tempted to use the category ‘bureaucratic entrepreneurs’ when referring to political business actors since we are talking about party and government officials engaged in revenue-generating activities aimed at promoting economic expansion using a vast array of institutional power within the state.¹¹

Even in the case of the US, during the catching-up process, economic historians have shown that “American industrialization was aided significantly by the intimate association of government and business. The railroad magnates were among the most important entrepreneurs in the American industrial revolution. Through bribery, chicanery and fraud, they amassed great personal fortunes. The federal government responded by generously giving federal lands to the railroads... Toward

⁹ Woodrow Wilson (1914), *The New Freedom*, Garden City, New York: Doubleday, pp. 57-58. Quoted in E. K. Hunt and J. Sherman (1972), *Economics: An Introduction to Traditional and Radical Views*, New York: Harper and Row, p. 302.

¹⁰ See also Lance L. P. Gore (1997), ‘Bureaucratic Entrepreneurs: Politically and Socially Embedded Economic Actors’, Working Paper No. 83, Asia Research Centre, Murdoch University, pp. 3-4 and 17.

¹¹ For a further discussion on the term ‘bureaucratic entrepreneurs’, see Gore, *ibid.*

the end of the nineteenth century, the relationship ... became a symbiosis in which the government governed in ways big business wanted it to govern and big business furnished the money, organization, and power structure through which politicians could come to power in the federal government.”¹² This form of political business has lasted until today, most manifest in the way big business funds presidential election campaigns.¹³

In the case of Germany, Bismarck’s bureaucracy, building on the thoughts of Friedrich List,¹⁴ created and nurtured a strong domestic business sector but one which had a symbiotic relationship with the state. Paul Sweezy stressed that “the ruling alliance of Junckers and capitalists has combined the reactionary and military stick features of feudalism with the economic strength and expansionism of a highly dynamic capitalism.”¹⁵ This pattern was repeated during the Fascist Hitler regime and again with the privatisation of the East German state property by Treuhaltanstalt after the demise of Soviet-type socialism.

A similar pattern of state-business collusion occurred in late 19th century Japan where the Meiji government built its own factories in key industries in order to catch up with the advanced nations of the West. These factories were then sold by the state to favoured private businessmen at ridiculously low prices. Mitsui and Mitsubishi, among Japan’s leading enterprises (or *zaibatsu*), were developed through such state patronage. A similar system of patronage has existed since the immediate post-World War II period.¹⁶

It can be argued that this form of state guidance of the economy in the US, Germany and Japan has been replicated in what is now termed political business relationships in the second-tier NICs in East and Southeast Asia, though with seemingly less success in Southeast Asia. However, as noted above, while political business alliances can become a strategy to channel available funds to strategic industries in a late-starting and capital-scarce country, if rents are created without the enforcement of a developmental quid-pro-quo by the beneficiaries, the strategy will have adverse effects on the economy.¹⁷

¹² Hunt and Sherman, *ibid*, pp. 318-19.

¹³ This was evidently clear when Bill Clinton was elected President with the aid of big capital in Wall Street as well as from Asia. See the article by Nicholas Kristoff with David E. Sanger, ‘How U.S. Wooed Asia to Let Cash Flow’, *New York Times* (16 February 1999).

¹⁴ An in-depth discussion of Friedrich List’s views on the benefits of the links between the state and business to promote economic development is provided later in this paper.

¹⁵ Paul Sweezy (1953), *The Present as History*, New York: Monthly Review Books, pp. 224-25.

¹⁶ See ‘Graft and the System’, *Far Eastern Economic Review* (6 August 1976, p. 80).

¹⁷ See Peter Evans (1999), ‘Transferable Lessons? Re-examining the Institutional Prerequisites of East Asian Economic Policies’, in Yilmaz Akyüz (ed.), *East Asian Development: New*

It would also be entirely wrong to assert that the type of political business observable in late-comers does not occur in developed countries as well. Examples are legion of the privatisation programmes in England, France and Italy and in Asia's Anglo-Saxon neighbours New Zealand and Australia which confirm the practise of a system of political patronage that has been implemented which in many cases has not been seen in the national interests. For example, while the privatisation policy has been heavily criticised in England,¹⁸ in Australia, allegations are rife of "over-familiarity between leading politicians and big business."¹⁹ This suggests that the relationship between business and the state in East Asia is not that peculiar as some theorists' and for instance the World Bank claims.

The World Bank Report 1991 identified four key features of East Asian policies and interventions that are important. First, these economies were noted for their outward orientation. Second, East Asia made sizeable and efficient investment in people. Third, the macroeconomic discipline of the public sector set an example for the entire economy. Public sector discipline in spending ensured that abuse of rents created through government interventions were minimised. Fourth, institutional development was crucial to the success of the 'market-friendly' growth paradigm. The state, rather than supplanting the market, supported it.²⁰ These features, collectively unique to East Asia, are used to justify support of market-oriented, outward-looking economic policies.²¹ In contrast to the neo-classical/liberal (and World Bank) explanation, a number of scholars have suggested that in any latecomer, state policies help to protect, promote and rationalise industry. This line

Perspectives, London: Frank Cass, p. 69.

¹⁸ For a critique, see *The Privatisation Network (1996): The Multinational Bid for Public Services*, The Public Services Privatisation Unit, London, January.

¹⁹ See Michael Malik, 'Labor's Business Mates: The 'Corporate State'', *Far Eastern Economic Review* (28 July 1988, p. 28).

²⁰ World Bank, *World Development Report 1991* (1991), New York: Oxford University Press. In a later study, the highly celebrated 'East Asian Miracle Report', the Bank became a bit more explicit by pointing out the *occasional* need for an active state role in instances where social returns exceed private gain and some degree of intervention can then make a large difference. This is a middle ground strategy emphasising some intervention in getting the fundamentals right and 'shared growth', but it is not *laissez faire* nor active industrial policy. World Bank (1993), *The East Asian Miracle: Economic Growth and Public Policy*, New York: Oxford University Press. See also the compelling critique and discussion in Albert Fishlow et al. (1994), 'Miracle or Design. Lessons From the East Asian Experience', Policy Essay No.11, Washington D.C: Overseas Development Council.

²¹ Neo-classical economists have attributed growth in the East Asian NICs and in Southeast Asia to government success at 'getting prices right', at letting free market-based price signals determine the most efficient allocation of resources for national economic growth.

of argument emphasises the strategic elements of policy that prove critical to maintain economic growth and develop industry.²²

A strategic trade policy²³ (which in reality is similar to a free trade strategy based on protectionism) is one whereby governments take action that gives commercial firms a credibility which they could not otherwise achieve. Technology stands at the center of such a policy and the strategy is concerned with the optimal way to combine protectionism, promote export-oriented industries and encourage international investment. Strategic trade policy maintains that comparative advantage can be changed through learning and through government action. This has been clearly shown by a number of East Asian countries which created competitive advantage through judicious interaction of government and private business.²⁴

Strategic trade policy is in fact the neo-classical catchword for neo-mercantilism or one-way free trade.²⁵ During the late 19th century, neo-mercantilism referred to the management of national economic and industrial policy, a concept given its most developed expression by Friedrich List. He pointed to the argument that the central importance of industry, and advocated a systematic, if essentially temporary, protection for a country's infant industries. The successful promotion of national industries required the preservation or development of suitable institutions and socio-economic structures. The central idea of neo-mercantilism is that economic activities are and should be subordinated to the goal of state building.

The essence of strategic trade policy cum neo-mercantilism lies in the efforts to promote national prosperity and to safeguard national interests by shielding the national economy against outside influences and through aggressive and discriminatory policies favouring domestic capital.

²² See the discussion in Robert Wade (1988), 'The Role of Government in Overcoming Market Failure: Taiwan, Republic of Korea and Japan', in Helen Hughes (ed.), *Achieving Industrialization*, Cambridge: Cambridge University Press; Robert Wade and Gordon White (1988), 'Developmental States and Markets in East Asia: An Introduction', in Gordon White (ed.), *Developmental States in East Asia*, London: Macmillan; and Robert Wade (1992), 'East Asia's Economic Success. Conflicting Perspectives, Partial Insights, Shaky Evidence', *World Politics* 44 (1), January.

²³ I use 'strategic trade policy' and 'neo-mercantilist policy' interchangeably.

²⁴ See among others, Alice Amsden (1989), *Asia's Next Giant. South Korea and Late Industrialization*, New York: Oxford University Press.

²⁵ For this and the following see Johannes Schmidt, *Models of Dirigisme in East Asia: Perspectives for Eastern Europe* (1996), pp. 196-216 in Jacques Hersh and Johannes Schmidt (eds) *The Aftermath of "Real Existing Socialism" in Eastern Europe. Between Western Europe and East Asia*, Basingstoke, London and New York: Macmillan & St. Martin's Press.

Therefore, by putting ‘politics in command’, the developmental state in the first- and second-tier NICs (Japan, South Korea and Taiwan) was a major factor in the success of East Asian late industrialisation and development.²⁶ The model was based on the implementation of a specific understanding of political economy, whereby the state assumed the role of guiding the economy without disregarding the importance of the market. Government policy-making was organically tied to the production factors - land, labour and capital - in actively creating comparative advantages. This type of political economy system implied an evolutionary approach to economic - and, presumably, political - development, and not a strategy of rapid radical reforms. In order to grasp the essence of the East Asian ideal-type developmental state, which has unfolded over time, with important deviations from country to country, it may be of interest to summarise some of its main characteristics:²⁷

- i) autonomy of the state (*vis-à-vis* interests groups);
- ii) state-exercised financial control over the economy;
- iii) co-ordinated or corporatised labour relations (either through the carrot or the stick);
- iv) bureaucratic autonomy (in key economic sectors);
- v) administrative guidance in giving preference to some industries over others;
- vi) favoured government treatment to private sector organisations, such as trading companies and industrial conglomerates (*zaibatsu*, *keiretsu*, *chaebol* or *caifa*); and
- vii) limited and controlled role for foreign capital.

Meredith Woo-Cumings, after discussing these interventions, argues that: “This is an ideal-type of a statist utopia that would make Adam Smith turn over in his grave: the state wields power over society and the market at home, and holds foreign interests at bay by means of its formidable gate-keeping power.”²⁸ State capacities and actions, however, never occur in isolation from the broader domestic and international environment.

The State and Economic Development in East Asia

East Asia’s economic strength was largely based on its ability to maximise its economic growth and exports and minimise imports. Its developmental model rested on a rejection of both communist-style state ownership of the economy and

²⁶ The following is based on Jacques Hersh and Johannes Schmidt “Dirigism or Laissez – Faire – Catching-up Strategies in the Global System After the Demise of Soviet-Style Command Economies. Working paper no. 54. pp, 10

²⁷ See also Chalmers Johnson (1987), ‘Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea and Taiwan’, in Frederic C. Deyo (ed.), *The Political Economy of New Asian Industrialism*, Ithaca: Cornell University Press.

²⁸ Woo-Cumings, Meredith (1994), ‘The “New Authoritarianism” in East Asia’, *Current History* 93 (587), p. 415.

the neo-classical belief that free markets and minimal state interference were the answers. In contrast to the dominant Anglo-Saxon *laissez-faire* point of view, neo-mercantilist ideals and practices shaped and fuelled Japan's economy, and was also very influential in Taiwan and Korea until the financial deregulation took place in the late 1980s. Until then, all financial institutions had been nationalised and strategic industries were targeted for development and declining industries nurtured through a dynamic mixture of corporate collusion and competition. Industrial policies were implemented through a range of mechanisms, including subsidies, import barriers, technology infusions and export promotions through successful access of East Asian companies to the large markets of North America and Europe.

Japan, and later on Korea and Taiwan, used the developmental state to improve their position in the world economy by holding back consumption and thereby increasing savings and channelling resources into industrial investment. This was made possible through a specific institutional set-up and its related capacity to implement certain industrial and trade policies.

Each of the following fundamental characteristics is also found in the Japanese, Korean and Taiwanese institutional framework although with differing degrees, depending on pattern of historical evolution and trade-offs arising from stressing one issue more than the other:

- i) stable rule by a political-bureaucratic elite that does not accede to political demands that would undermine economic growth or security;
- ii) co-operation between public and private sectors under the overall guidance of a pilot planning agency;
- iii) heavy and continuing investment in education, combined with policies to ensure a relative equitable distribution of national income; and
- iv) a government that understands the need to use and respect methods of intervention based on the price mechanism. Furthermore, the concept of dirigisme denotes a mix of political and economic functions where the notion is the 'government that governs best governs most' (see also Table 1).

Table 1

State Intervention in East Asia Before Liberalisation

State Policies	Outcomes
Neo-mercantilism	Import Substitution/

	Export Orientation
Non-welfare	High savings/Low interest rates
Moderate consumerism	Channelling of resources to industrial investment
State-productive/financial capital corporatism	Exclusion of labour
Soft authoritarianism	Political stability
U.S. security umbrella	Non-defence

Japanese industrial policies, and to a certain extent that of the states of Korea and Taiwan, were characterised by ‘controlled competition’ in which intense competition between firms in key industrial sectors was partly directed and at times limited by both state action and the formal and informal collaborative efforts between industrial and financial enterprises. The precise rules guiding the system evolved with the structure of the economy, the financial and market strength of the companies, and the political position and objectives of the bureaucracy.²⁹

The promotion of the state’s objectives in Japan were pursued through two sets of policies - those controlling the links between the Japanese market and international markets and those manipulating the domestic enterprises to stimulate expansion. T.J. Pempel once characterised the Japanese state as an ‘official doorman’ determining what, and under what conditions, capital, technology and manufactured products could enter and leave Japan. This pattern of controlled access, until recently, characterised the functioning of the Ministry of Finance which implemented policies involving selective controls over inward investment. The Ministry of International Trade & Industry (MITI) controlled technology imports in order to force foreigners to sell raw technology in the form of patents, licenses and expertise.

The state in Japan used a system of non-compulsory indicative planning and administrative guidance to accomplish stated objectives. Government plans identified the strategic targets, provided guidance for industrial policy and bolstered confidence of the domestic business community.³⁰ Plans were adjusted according to

²⁹ Michael Borrus, Laura D’Andrea Tyson and John Zysman (1988), ‘Creating Advantage: How Government Policies Shape International Trade in the Semiconductor Industry’ in Paul R. Krugman (ed.), *Strategic Trade Policy and the New International Economics*, Cambridge: MIT Press.

³⁰ The distinction between plan-rationality and market-rationality is made by Chalmers Johnson

changes in basic trends of supply and demand. According to Sato, in carrying out indicative planning, the Economic Planning Agency had a number of policy instruments at its disposal including expenditure policy, tax policy designed to promote savings in order to finance capital formation, various extensive off-budget activities such as funds collected by the Postal Savings System, subsidising industries through favouritism and protectionism, credit policy support, research and development policies that strongly favoured strategic technology innovation and application, agricultural policy that protected Japanese farmers' interests and solidified political support from rural constituencies, and trade policy effectively promoting Japanese exports.³¹

These observations are consistent with Wade's analysis of South Korea and Taiwan where the state actively intervened in the trade regime and managed commercial relations. Tariff and non-tariff instruments of protection (for instance, permitting imports of specific products only from countries that were non-competitive suppliers) continued to be significant in influencing the direction of industrialisation. In most instances, protection of the domestic market depended on the ability of companies to become competitive in international markets. During the same period, the state maintained tight control over foreign investment through industrial licensing, the imposition of local content requirements and by making protection of foreign investment conditional on performance. The state exerted tight control over the financial sector and allocation of credit, i.e. through exclusion of foreign banks. State-owned enterprises and parastatals played a significant leadership role in the corporate sector, enabling the authorities to direct discretionary investment incentives and determine which key sectors should be upgraded or downgraded.³²

The case of Japan and the second-tier NICs suggests that the achievement of high-speed economic growth depends on the state standing above vested interests to help create the social and political infrastructure for economic growth. In short, technocrats need a degree of insulation, but they cannot operate in isolation, even in an authoritarian setting.³³ In Japan, for example, the importance of the autonomy of the bureaucracy rests on its pivotal position between the ruling Liberal Democratic Party (LDP) and big business. While the LDP had nominally controlled both the legislative and administrative branches of government for more than two decades,

(1986), 'The Non-Socialist NICs: East Asia', *International Organization* 40 (2).

³¹ A useful discussion on the nature of indicative planning is found in Kazuo Sato (1990), 'Indicative Planning in Japan', *Journal of Comparative Economics* 14, pp. 625-647.

³² See the two concluding chapters in Robert Wade (1990), *op cit.* pp. 297-381.

³³ Evans (1992), p. 178.

public policy was, until recently, made by, and largely at the discretion of, senior bureaucrats.³⁴

The Japanese state, which has been accused of having been a free-rider in the economies abroad, also escaped to a certain degree social obligations in the domestic context.³⁵ The transformation of the Japanese economy from a warfare to a trading state within a brief period of time can be attributed to limited resources spent by the state in the defence and social sectors. Indeed, this complements the explanations mentioned above of how Japan has managed to continuously increase national capital accumulation in terms of trade surplus and other revenues cum profits.

The gears of government and the private sector arguably do mesh better in Japan than in Southeast Asian NICs. Much of the credit for this goes to Japan's powerful senior bureaucrats who provided the vital connections between political and business establishments on practically all important issues of public policy, and who methodically steered both sides towards national objectives. Ex-bureaucrats were until the 1990s highly prized in the corporate world because of their detailed knowledge of the inner workings of official policy-making and their wealth of personal connections in business, politics and the bureaucracy.

Southeast Asian Economic Development: Impact of Foreign Capital

Contrary to the acknowledged role of statism in the evolution of Japan's economy, the ASEAN-4³⁶ has had a more dependent relationship with international capital to foster economic growth thus creating fertile ground for another type of political business alliance. The significance of international influence on the ASEAN-4 economies was underlined by a 1996 UNCTAD report which issued a clear warning that these countries relied too heavily on foreign resources, both labour and capital: "Thus, the second-tier NIEs may be unable to sustain large current-account deficits over the longer term; they need to reduce their trade deficits so as to minimize the risk of serious balance of payments problems and a sharp slowdown in growth. Much will depend on their success in enhancing their export potential through upgrading.... Without upgrading...FDI (foreign direct investments) will remain footloose and the economy would be highly vulnerable to interruptions of capital inflows. Concerns over such a possibility have been

³⁴ Since the late 1980s, the autonomy of the bureaucracy has increasingly been challenged. Fierce inter-agency competition and a push from below by local constituencies for greater involvement in policy-making has complicated this quite static set-up between the LDP and the bureaucracy.

³⁵ Numerous complaints have been made, especially by the US, about Japan's ruthless attack on global markets and its bombardment of trading partners with products, disregarding local industrial or economic conditions.

³⁶ Indonesia, Malaysia, Thailand and the Philippines.

growing in Thailand and even more in Malaysia in view of their large current account deficits.”³⁷

Much of the FDI in Southeast Asia since late 1980s had its origin in East Asia, first from Japan and subsequently from Taiwan and Korea. As illustrated in Table 2, Malaysia was the main destination of FDI while Indonesia and Thailand were less important in terms of total FDI flows between 1985 and 1994. The Philippines were least important, suggesting that there is some credence to the thesis that an unstable political climate and a weak state with a limited capacity to impose coherent policies attracts little foreign capital. One major weakness of the second-tier NICs was noted in UNCTAD’s 1996 Trade and Development Report, that with the important exception of the Philippines, the other three Southeast Asian economies were praised for the successful policies which had helped in establishing competitive resource- and labour-intensive industries, but the easy stage of export promotion was coming to an end. Already here UNCTAD issued a clear warning: “noting that growth in the region relied excessively on foreign resources, both labour and capital,” thus, “[m]uch will depend on their success in enhancing their export potential through upgrading ... Without upgrading ... FDI will remain footloose and the economy would be highly vulnerable to interruptions of capital inflows.”³⁸

FDI moved into a number of export-oriented industrialisation (EOI) sectors across the region where supply far out-stripped demand. Steel, cars, petrochemicals and semiconductors, to name a few, were industries where massive foreign investment was made on the unquestioned assumption that record-beating growth would continue indefinitely. The extremely large inflows of productive capital did benefit high-speed growth; for example, in the second half of the 1980s, Malaysia, Thailand and Indonesia experienced similar growth rates as South Korea and Taiwan in the 1970s, but contrary to their experience the Southeast Asian countries did not build on an experience of successful import-substitution. Unlike the case of East Asia, in Southeast Asia, export-oriented manufacturing soon came to be dominated by subsidiaries of transnational corporations (TNCs).³⁹

Table 2.2

DFI Flows to Southeast Asian Countries, 1985-1994 (US\$ million)

³⁷ Trade and Development Report 1996, UNCTAD, Geneva, pp. 102 and 123.

³⁸ See Yilmaz Akyüz (1998), ‘The East Asian Financial Crisis: Back to the Future’, paper presented at a seminar on ‘Impacts of the Asian Currency Crisis on Europe’s Growth Prospects’, EIAS, Brussels, 20 January, pp. 1-2.

³⁹ Mitchell Bernard and John Ravenhill (1995), ‘Beyond Product Cycles and Flying Geese. Regionalization, Hierarchy, and the Industrialization of East Asia’, *World Politics* 47, January, p. 172.

Country	1985	1990	1991	1992	1993	1994
Indonesia	310	1,093	1,482	1,777	2,004	2,109
Philippines	12	530	544	228	763	1,000
Thailand	163	2,444	2,014	2,116	1,726	640
Malaysia	695	2,333	3,998	5,183	5,006	4,348

Source: World Bank (1996), *Managing Capital Flows in East Asia*, Washington D.C: World Bank, p. 28.

In some cases, Southeast Asia emerged as a lucrative market for TNC products. One example is Toyota, which invested heavily in the region in order to reduce its dependency on the US car market. Thailand became the company's second largest market in 1996, and Toyota-Astra Motor accounted for a similar share of the Indonesian market.⁴⁰ Another heavyweight in terms of FDI in Southeast Asia is Seagate Technology Inc., a leading manufacturer of disk drives, and a prototype 'stateless corporation', moving first to Singapore and then to Thailand. The presence of Seagate, as well as other TNC's such as Mitsubishi, Motorola, Texas International, Intel, National Semiconductor and Harris (formerly RCA), in the ASEAN-4 economies indicates their heavy reliance on foreign capital to generate growth.

Corporate Japan has a particularly strong presence in Southeast Asia. Japanese affiliates employed an estimated 800,000 people across ASEAN economies in 1994. In a number of key industries, Japanese firms have staked out a commanding regional position, with Matsushita Electrical Co. Ltd.'s operations alone said to account for between 4 percent and 5 percent of Malaysia's gross domestic product. Japanese manufacturers currently control about 90 percent of the automotive market in most ASEAN countries.⁴¹ Yet, and more importantly, there is little evidence that most of these TNCs have shown great reluctance to transfer technology to their joint venture partners in the region, an issue openly lamented by some Southeast Asian leaders. There are, however, nationalist incentives as well simple altruistic considerations which condition the view of state and policy elites to nurture and co-ordinate FDI. Moreover, this dependency on foreign capital to promote economic development creates much space for corruption in developing

⁴⁰ Gavin Boyd (1989), *Pacific Trade, Investment and Politics*, Pinter: London, p. 114.

⁴¹ Quoted in Robert Wade (1994), 'Selective Industrial Policies in East Asia: Is *The East Asian Miracle* Right?', in Albert Fishlow et al., op cit., pp. 66-67. See also Walden Bello (1997), 'Addicted to Capital: The Ten-Year High and Present-Day Withdrawal Trauma of Southeast Asian Economies', www.focusweb.org/focus/library.

economies.⁴²

Dependency theorists have noted three important points about investments by TNCs.⁴³ First, the advantages of foreign direct investments are unequally distributed between TNCs and host countries because TNCs have the ability to absorb gains that could otherwise be reinvested. Second, TNCs create distortions in the economy by displacing domestic production, utilising inappropriate technology and distorting consumer tastes. In addition, their behaviour leads to a worsening of income distribution. Third, TNCs may pervert, undermine or influence the political system of host countries.⁴⁴

Peter Evans has noted the different outcomes of the alliances created between TNCs and politicians in host societies.⁴⁵ Recognition of the importance of state capacity, not simply in the sense of the power of technocrats within the state apparatus but also in the sense of an institutional structure that is durable and effective, is characteristic of what Evans terms “the third wave of thinking about state and development.”⁴⁶ The East Asian states are what Evans terms ‘embedded states’ which, in contrast to the ‘predatory’ state such as Zaire, has a large degree of autonomy which “depends on an apparently contradictory combination of Weberian bureaucratic insulation with intense immersion in the surrounding social structure.

⁴² Corruption has become a widespread global problem, with TNCs sometimes paying huge bribes to win business. Bribes usually consist of approximately 10-20 percent of the costs of a deal, which may be paid to both public officials and politicians. What is most significant, however, is the fact that this amount in many cases is added to the total cost of the business deal. See for instance George Moody-Stuart (1997), *Grand Corruption, How Business Bribes Damages Developing Countries*, Oxford: WorldView Publishing.

⁴³ There is some concern over the influence of TNCs in the world economy. At the end of the 20th century, TNCs accounted for 80-90 percent of world trade (excluding the former planned economies, though even in these economies it has acquired more than a foothold interest). The pace of capital concentration into fewer and larger corporations has been sped up to levels hitherto unimagined. For a further discussion on TNC influence in the global economy, see Frederick C. Clairmonte (1988), *The Political Economy of Transnational Power in Partisan Scholarship: Essays in Honour of Renato Constantino*, JCA, Manila.

⁴⁴ Volker Bornschier and Hanspeter Stamm (1990), ‘Transnational Corporations’, *Current Sociology* 38 (2/3), Autumn/Winter, p. 206.

⁴⁵ Peter Evans (1979a), *Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil*, Princeton, NJ: Princeton University Press. Peter Evans (1987), ‘Class, State, and Dependence in East Asia: Lessons for Latin Americanists’, in Frederic C. Deyo (ed.), *The Political Economy of the New Asian Industrialism*, Ithaca: Cornell University Press. Peter Evans (1992), ‘The State as a Problem and Solution: Predation, Embedded Autonomy, and Structural Change’, in Stephan Haggard and Robert R. Kaufman (eds), *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State*, Princeton, NJ: Princeton University Press.

⁴⁶ Evans 1992: 141.

How this contradictory combination is achieved depends, of course, on both the historically determined character of the state apparatus and the nature of their social structure in which it is embedded...”⁴⁷

The institutional capacity of the state depends on the nature of the state of which Evans has noted three different types. The ‘predatory state’, with Zaire as an example, lacks bureaucratic capacity and has a weak organisational structure in its domestic setting. Furthermore, the state lacks autonomy in its ties with international actors and institutions which affects its capacity to bargain effectively, especially since it is kleptopatrimonialist in the sense that it is highly corrupt and rent-seeking is widespread through a personalised rule and a more or less uncontrolled market. An example of the ‘intermediate state’ is Brazil. The state’s internal structure is fragmented, divided, segmented and unstable but occasionally it has had a degree of embedded autonomy vis-a-vis external forces. In contrast, the ‘developmental state’ has a high degree of embedded autonomy and some degree of insulation and social connectedness. The state is supported by a stable, coherent and comprehensive bureaucratic organisation, what Evans calls “reinforced Weberianism.”

The essential argument made by Evans on the role of the state in development can be encapsulated in three points.⁴⁸ First, developmental outcomes depend on both the general character of state structures and the roles states pursue. Second, state involvement can be associated with transformation even if we take sectoral policies such as labour policy, land reforms or other redistributive policies as measures. Finally, an analysis of states and industrial transformation cannot stop with the emergence of the industrial landscape. Successful transformation changes the nature of the state’s private counterparts, making effective future state involvement dependent on the reconstruction of state-society ties.

In Southeast Asia, TNCs have been more concerned with establishing ties with the domestic political elite in an attempt to penetrate the market. TNC penetration into the Southeast Asian economy has primarily been through joint ventures. The TNCs in Southeast Asia also tend to establish political business alliances which were potentially profitable for them and the domestic political elite but not in the national interest.

In Thailand, for example, local businessmen have managed to develop their corporate base by establishing ties with the political elite as well as with foreign enterprises. Some businessmen have also used such ties to secure political power. For this reason, many of the decisions taken by the cabinet and ministries involved in implementation of key projects were made in a manner baffling to all but those

⁴⁷ Evans 1992: 154.

⁴⁸ Evans 1995: 17.

firms won the contracts. This situation gave rise to widespread speculation that corruption was rife within the state, and the government's perceived failure to address this problem was considered by many as sufficient proof of extensive corruption. One example was the privatization of telecommunications services by the government, indicative of what has been referred to as the 'perfect connections' required to rapidly build up an enterprise.⁴⁹ Taksin Shinawatra, a retired police colonel and scion of a prominent northern Thai family known for its silk-fabric business, who had good relations with the Thai bureaucracy had left his job in police-information processing to sell and lease IBM computers to the government. As IBM's sole agent in Thailand, Shinawatra built up a 90 percent market share of computer sales. Shinawatra also secured a deal to sell equipment to a US\$6 billion project undertaken jointly by British Telecom and the Charoen Pokphand group, a leading Sino-Thai enterprise; the project involved the installation of two million telephone lines in Bangkok and one million lines in rural areas.⁵⁰ Shinawatra subsequently entered mainstream politics and is now seen as a potential candidate for the post of Prime Minister of Thailand.

In Malaysia, the government's liberalisation policies have been primarily responsible for the surge in foreign and domestic investment which fuelled economic growth, particularly after a severe recession in the mid-1980s. However, the privatisation policy, part of the government's liberalisation initiatives, became an important avenue through which members of the ruling United Malays' National Organisation (UMNO) and well-connected businessmen have benefited from state patronage. Many of these privatised contracts have been implemented through joint-ventures with foreign companies.⁵¹

While there is a productive dimension to FDI, i.e. they take over and control productive manufacturing enterprises in ASEAN, there has also been unproductive investments in stocks (i.e. direct portfolio investments – DPI) and property as well as loans from foreign banks. Like Thailand, the Philippines liberalised the foreign capital account in the mid-1990s and the banking sector with the result that between 1993 and 1997, approximately US\$19.4 billion worth of net portfolio investment flowed into the country. These flows dwarfed the FDI inflows, with estimates of DPI volume ranging from 75 to 90 percent of total investment.⁵² In Thailand, by 1996, local companies and individuals had loans totalling more than US\$70 billion – a figure equivalent to more than half the country's gross domestic product. Thai

⁴⁹ *Far Eastern Economic Review* (6 December 1990: p. 18).

⁵⁰ Paul Handley, 'Thai Telecoms Firm is Politically Astute: Contact Network', *Far Eastern Economic Review* (13 December 1990: p. 70).

⁵¹ See the chapter on Malaysia in this volume for an in-depth discussion on UMNO patronage and the implementation of privatised contracts with the support of foreign enterprises.

⁵² Bello, *op cit.* pp.9.

companies over-invested in redundant manufacturing, and especially in property and land. By the beginning of 1997, half of the loans made to property developers were non-performing.

The role of foreign funds flows into the ASEAN-4 in the form of FDI and FPI indicates the various forms in which foreign capital operates in these economies. As noted by Rajah Rasiah: “It is clear that free currency and capital markets exposed the crisis-affected Southeast Asian economies to substantial systemic risks, destabilizing them seriously when external volatility suddenly exploded.”⁵³ Although dependency may facilitate increased productivity and enhance skill formation, it can also inhibit indigenous innovation. Dependency can also create political sensitivity among bureaucrats and politicians who might perceive it as an obstacle to their policy and power options.⁵⁴

Besides the prominent role of foreign capital in the ASEAN-4 economies, companies controlled by ethnic Chinese have proven to be the most dynamic among domestic enterprises. Chinese ownership and control of the ASEAN-4 economies has been an issue of great sensitivity in these multi-racial societies. None of the NICs has ever had to cope with anything like this. While ethnic Chinese entrepreneurial skills have been beneficial in contributing to the opening up of the regions and societies where indigenous enterprise and capital were scarce,⁵⁵ the social and political problems associated with the Chinese minorities are quite disproportionate to the numbers involved because of their high socio-economic status. All four ASEAN governments have, at times, sacrificed efficiency-maximising considerations for the imperatives of economic nationalism involving measures disadvantageous to ethnic Chinese. Measures of this kind have been blatantly discriminatory during the last thirty years or so (except in the past two decades in Thailand), and it will probably be a long time before it ceases to be

⁵³ Quoted in Rajah Rasiah (2000) *From Dragons to Dwarfs: Re-examining Neo-Liberal Explanations of the Southeast Asian Financial Crisis*, Development Research Series, Working Paper no. 84, DIR, Aalborg University, p.20.

⁵⁴ For an excellent discussion of dependency's impact in the region, see Bernard and Ravenhill, *op cit.* pp. 208-09.

⁵⁵ On the early history of Southeast Asian Chinese, see William Skinner (1957), *Chinese in Thailand: An Analytical History*, Ithaca: Cornell University Press and M. Somers-Heidhues (1974), *Southeast Asia's Chinese Minorities*, Hawthorn: Longmans Southeast Asia Series. For a contemporary account of Chinese enterprises in Southeast Asia, see Edmund Terence Gomez (1999), *Chinese Business in Malaysia: Accumulation, Accommodation and Ascendancy*, Honolulu: University of Hawaii Press, D. Chirot and A. Reid (eds) (1997), *Essential Outsiders: Chinese and Jews in the Modern Transformation of Southeast Asia and Central Europe*, Seattle: University of Washington Press and Ruth McVey (ed.) (1992), *Southeast Asian Capitalists*, Ithaca: Cornell University Press.

a constraint upon government policy-making.⁵⁶ Moreover, the Chinese remain open to allegations of wealth concentration which has undermined the development of indigenous capital in spite of the extensive control of the state over the economy in most of these ASEAN-4 countries. Such allegations usually arise during periods of economic crisis. For example, the significance and collusion of ethnic Chinese and foreign capital allegedly partly explains the financial crisis in the ASEAN-4, specifically in Indonesia and Thailand. Undoubtedly, however, many of the indigenous business elite has established similar corporate ties with foreign capital to promote their economic interests.

The role of Chinese business in the ASEAN-4 is still limited with regard to its capacity to influence economic policy formulation and implementation. Despite the fact that there are considerable differences in the structure of political business ties among domestic players, it can, however, safely be claimed that ties between state and capital, from the outset, were also created by policy elites with a nation-building perspective in mind and as a means to develop indigenous capital. Such ties also served to check the growing influence of foreign capital in the ASEAN-4 economies. In Malaysia and Indonesia, political business ties were a means to check the influence of Chinese capital interests; in both countries, although capital accumulation by Chinese enterprises has been significant, Chinese capital remains very subservient to the state.

An important difference can be noted here between the impact of political business ties in Southeast Asia as compared to East Asia. In early stages of development in Japan, and later on in South Korea – as was the case in the US and Germany – political business alliances led to the development of what can be termed as ‘nurtured entrepreneurs’. In these cases, a strong business sector was nurtured and subsidised by an autonomous state behind protective walls. In Southeast Asia, however, the evidence suggests that what emerged were primarily ‘dependent comprador political business alliances’, i.e. weak indigenous capital operating in an economy characterised by the strong position of ethnic Chinese enterprises along with a dependence on foreign capital to promote economic growth. The result was a “lack of institutional deepening to sustain efficiency improvements”, and this “seriously restricted the performance of real sector firms.”⁵⁷

The State, Corruption and Corporate Development

The development of the economy in East and Southeast Asia following democratisation brings into question the conventional wisdom that the free market and democracy are hinder corruption in government. In their report entitled, ‘The

⁵⁶ J.A.C. Mackie (1988), ‘Economic Growth in the ASEAN Region: The Political Underpinnings’, Helen Hughes (ed.), *Achieving Industrialization*, pp. 297-98.

⁵⁷ Rajah Rasiah, op.cit, pp 18.

New Corruption', Barbara Harriss-White and Gordon White noted that⁵⁸ "in some contexts . . . the amount of corruption has increased along with and apparently as result of economic liberalisation." The replacement of discretionary controls over prices and the production and distribution of goods and services should according to theory limit the scope for rent-seeking behaviour within the state. A separate report, based on empirical studies in southern India suggests that deregulation may be accompanied by "mutations in relations of corruption" or it just displaces corruption to other actors and spheres of activities. In other words, Asia is dealing with new forms of graft that have adjusted to or are products of liberalisation and deregulation.

If economic reform does not automatically quell corruption, neither does democracy. Following the 1996 general election in Thailand, which was widely regarded as the 'dirtiest' ever, some observers concluded that democratic politics stimulated corruption. In this environment, in the implementation of Thailand's development plans, especially infrastructure projects, there were numerous avenues for politicians with the help of foreign and domestic capital to indulge in illegal money-raising activities. In the Philippines, bribery allegations threatened to turn the US\$2.3 billion Manila Bay land-development project into the biggest scandal of President Fidel Ramos's tenure. Opposition senators claimed the project's developer paid kickbacks to officials of the government agency that sold the land and to Ramos' Lakas-NUCD Party.

In South Korea, Thailand and Indonesia, instances of corruption have typically come to light in the wake of political upheaval, as new leaders try to gain mileage by taking their predecessors to task for past offences. Similar allegations of corruption, involving nepotism and cronyism, were made by Malaysia's former Deputy Prime Minister Anwar Ibrahim when he was removed from office by Prime Minister Mahathir Mohamad. The scale of political patronage in Malaysia, especially through privatisation, has been significant, justified as a means to improve the efficiency of public enterprises, though it has led to numerous allegations corruption and conflicts-of-interest involving senior politicians. While most recipients of political patronage depend heavily on foreign or Malaysian Chinese companies to implement the concessions they secure from the government, questions have also been raised of the form of corporate development undertaken by those privies to much state support.

One of the most important lessons of the financial crisis is that Southeast Asia's remarkable rates of economic growth, together with the emergence of new

⁵⁸ This and the following is quoted from Aparisim Ghosh et al., 'Corruption: Reform's Dark Side' (*Far Eastern Economic Review* 20 Mar 1997, p. 18).

corporate high fliers, have to a very large degree been a phenomena that has masked the reality that many of the largest enterprises possess few of the fundamentals necessary for long-term viability. Southeast Asia's industrial growth has, in contrast to Japan and the second-tier NICs, been too heavily dependent on foreign investment and technology, devoid of an indigenous technological culture or a domestic base of capital for long-term productive investment. Instead, a business culture has been incubated involving much short-term speculative activity in trade, finance and property, combined with a scramble to seek profits and commercial advantage through political patronage. The dynamism of these economies is attributable primarily to foreign investors and to the ubiquitous Chinese enterprises which tend to dominate the most productive domestic side of economic activity.⁵⁹

In conclusion, the state in Southeast Asia has not been successful in nurturing entrepreneurial domestic capitalists in spite of the extensive state support the latter has received. The key difference in political business ties in the ASEAN-4 as opposed to the NICs is that the former have relied too heavily on foreign capital and has not managed to develop a significant number of independent, dynamic, growth-oriented large-scale enterprises. One reason for this is that the ties between politicians and business in Malaysia, Thailand, the Philippines and Indonesia (and to a certain degree Korea) have been far too close. This was not the case in Singapore, the one country which has a strong state and minimal corruption. In Taiwan, the KMT had been financially independent of capitalists and KMT leaders never saw the need to cultivate close ties with businessmen. The extent of autonomy of the state from business suggests that this enables the state to act in the national interest as well as keep a check on corruption.

I have argued that the financial crisis was not triggered by a unique East Asian model of statism creating distortions and inefficiencies and involving a specific mode of cronyism or political business with the direct consequence of misallocation of resources. This study does, however, argue that economic liberalisation does not necessarily lead to a reduction of corruption. In fact, the basic problem is underregulated markets, at both the national and international levels, indicating the need to discipline markets and steer policies in a predetermined direction in the national interest.

⁵⁹ Richard Robison, 'Doing it their way', review of *Behind the Myth: Business, Money and Power in Southeast Asia* by James Clad, London: Unwin Hyman in *Far Eastern Economic Review* 8 February 1990, p. 36.

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